The role of IP management in mergers and acquisitions

A growing number of companies understand that M&A deals which fail to consider the IP issues involved in a tie-up can end up causing more problems than they solve. A group of senior in-house IP professionals discussed a number of M&A-related IP issues at a recent LES meeting in Paris

By **Bill Elkington**

Recently, I sat down with a few senior corporate IP management leaders in the consumer electronics/high-technology, energy and venture capital industries to discuss the general role of IP management in their companies' M&A activities – and more specifically, their role in the development of M&A deal structures and in the conduct of M&A due diligence. In addition, we discussed how and why such transactions typically succeed or fail. This conversation followed a September 2011 meeting sponsored by the Licensing Executives Society (LES) called the IP100.

IP100 meetings are designed for senior IP management leaders from IP-owner organisations to share best practices and work together to find solutions to common problems. These invitation-only events were initially developed by LES (USA & Canada), but are now being hosted by LES societies around the world.

The focus of the September 2011 IP100 meeting in Paris was IP transactions best practices and, more specifically, IP-centric M&A transactions. This topic seemed particularly appropriate given the recent purchase of the Nortel patent portfolio and Google's purchase of Motorola Mobility earlier in 2011.

I interviewed the following three senior IP management leaders:

- Alfred Chaouat is senior vice president for licensing at Technicolor SA, a French international provider of solutions for creation, management, post-production, delivery and access to video in the communications, media, and entertainment industries. He is responsible for generating income from the company's patent portfolio through direct out-licensing and through patent pools. He is also responsible for protecting Technicolor's freedom of action through patent cross-licences, and is involved in patent-centric work in the company's M&A and divestment activities. Mr Chaouat is also the current president of LES France.
- Sophie Dingreville is a partner with Iris Capital, a leading pan-European venture capital firm with €870 million invested in 200 companies. She is responsible for investments in technology and digital media. The company was founded in 1986 in Paris.
- Fabirama Niang is vice president of intellectual property for Total SA, a French multinational oil company – one of the six largest oil companies in the world – and a large-scale chemicals manufacturer. He is responsible for setting and managing Total's IP policy and for ensuring the protection, defence and exploitation of the company's intellectual assets. He also advises the company on its scientific direction and supports the company's business units regarding IP issues.

Here is what our experts had to say.

IAM is the Official Strategic Media Partner of LES (USA & Canada). As part of this wide-ranging cooperation agreement, both parties work together to provide thought leadership relating to the strategic creation of value from intellectual property. With this in mind, every issue of IAM features an exclusive article written by an LES member or members that focuses on an IP value creation topic. The content and authorship of the article is always agreed in advance with the IAM editorial team and is subject to the same editing process as all other articles published in the magazine. The work and the opinions of the author(s) are personal to the author(s) and do not represent those of LES (USA & Canada).

In your company's M&A activities, what is the role of IP management? Is it central or peripheral? Is it risk-management oriented or opportunity-capture oriented?

Alfred Chaouat (AC): At Technicolor, the person responsible for intellectual property is always part of the steering committee set for each M&A project. Intellectual property is very central and could be a deal breaker for acquisitions or divestments. However, it remains a risk-management-oriented role. IP acquisition *per se* is directly managed by the IP management team, not the M&A team.

Sophie Dingreville (SD): IP management is key when investing in a technology-centred company (with patents) and in a content-driven company (with rights and copyrights). It is definitely opportunity-capture oriented.

Fabirama Niang (FN): Total SA' s M&A activities are led either by the corporate M&A function or by a business unit, depending on the situation. But in either case, my office – the corporate IP office – evaluates the ability of the target's IP portfolio to protect its freedom to operate and determines what encumbrances, if any, the portfolio may have.

How does your organisation handle approval of IP acquisitions and divestitures? What level of management gets involved and how are these decisions made?

AC: We have a dedicated team within our patent and licensing organisation working on the project. This group gives an initial project presentation to the patent and licensing steering committee. Then, if approved, the project is presented for final approval to the corporate investment committee, chaired by the company's chief executive. Depending on the amount, approval from the board of directors may also be needed.

SD: Iris Capital's investment committee approval is needed for strategic IP acquisition and divestment in portfolio companies when additional funding is required. Approvals from an Iris Capital representative, as well as the board of directors of the portfolio company, are needed for IP acquisition and divestment when the deal has a significant impact on the operation, organisation and/or future strategy of the portfolio company.

FN: The board of investment in the acquiring division approves the purchase, taking into account the diverse inputs of the different disciplines represented on the due diligence team – intellectual property being one of them.

What is your preferred IP transaction type – sale/purchase or licensing? And what is the rationale for your preference?

AC: Licensing is preferred because we believe we can derive more value from licensing than we can through a sale. However, there may be some exceptions to this – especially in cases where buyers need to own patents for strategic reasons.

SD: This is really determined on a case-by-case basis. The rationale for the preference depends on the anticipated effect it will have on the valuation of the portfolio company at the time it will be exited (eg, when it is acquired by a strategic buyer or when its shares are first sold on a public market).

FN: We engage in different IP transaction types depending on the circumstances. There is no preferred kind of transaction. In M&A activity, we most often invest in companies with which we have established research partnership agreements to develop technologies that look promising for the distant future. Alternatively, we will sometimes establish R&D partnerships to enhance our knowledge about a technology we already have invested in. And we may establish such an R&D partnership to finalise the development of a technology that will soon be implemented in our processes. In-licensing, out-licensing and cross-licensing are often used when we intend to put a new plant in place with newly developed processes. In such case we will often have technology, and perhaps investing partners, and in these cases licensing may prove the most practical and financially beneficial approach.

What is the role of option agreements in your IP transaction work, whether these are options for purchase/sale or for licensing?

AC: We use option agreements mainly in in-licensing IP transactions with universities and very seldom for patent out-licensing. For example, there could be a scenario where we would give a potential patent licensee the option to extend the

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licence agreement at the end of the term at a pre-determined price - perhaps for a term of five years. The licensee therefore knows five years in advance the maximum cost of a possible extension. This is primarily to the patent licensee's benefit, so we try to avoid this kind of option.

FN: At Total, options are used in some R&D partnership agreements. They can guarantee us the possibility of acquiring the IP rights arising from the partnership.

When you do IP transactions with universities whose research you have funded, is it important to have a cap on the value that you would pay? If so, how is that cap determined? What is your rationale for requiring a cap, if in fact you require one?

AC: In most cases the development agreement includes an option to buy out the university at a pre-determined price when co-owned patents result from research we have funded. The price may include a share of future licensing income in case of a blockbuster patent. And in such cases - when the university obtains future licensing income as compensation for selling us its ownership interest in a blockbuster patent — we will typically insist on a cap.

SD: We do not necessarily require a cap in university licensing transactions. However, we might put a cap in place in cases where a change of control (rather than an initial public offering) is contemplated for a portfolio company that is taking a licence (or has taken a licence) to university technology. Such a provision is designed to reduce the financial uncertainty that an acquirer might have when considering purchasing such a company. In fact, even persuading a potential strategic investor to invest in the portfolio company may be difficult without such a cap, because that potential investor's endgame may be the purchase of the company at the appropriate time.

FN: In such case a cap is important for being able to manage our budget. Further, evaluating the impact of a patent on our business is very difficult, if not impossible, and the only way to solve the financial feasibility question is to define a fixed or maximum price. Except in some very downstream research, the only way to fix such an amount at this stage is to rely on the actual cost of the development.

In your company, what is the relationship between the IP management and M&A functions? How do you assign responsibility for transactions between the two? Are the metrics in the two functions similar or different?

AC: The M&A function puts a project team together for each potential acquisition/divestment. The project leader is from the M&A organisation and an IP management member is part of the steering committee for the project. The metrics are different. For example, in the case of a divestment, the M&A organisation may want to close the deal even if it would have to transfer more intellectual property than IP management would agree to. In such cases a negotiation within the project's steering committee will be required, to reach an agreed-to approach.

SD: In our experience with small and medium-sized companies, IP management tends to involve more R&D team members, while M&A functions involve more financial

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team members. The IP management and M&A functions work very closely when there is a specific deal on the table.

FN: Our IP department and M&A department are both in the Total legal department. They work together on a cross-support mode without any hierarchy between them. As they represent very different subjects, they don't share any metrics.

Briefly describe key deal characteristics of a typical IP-centric M&A deal that your company does?

AC: For us, key deal characteristics would include price, number of patent families, transfer of the patent file histories, prior licence commitments and possibly royalty sharing.

SD: The typical IP-centric M&A deal that Iris Capital does is an investment in an IP-centric company and the sale of its stake in such a company or the sale of the company itself. Key characteristics include:

- The capability of the team that has produced this intellectual property and will continue developing it.
- The team's motivation for such a deal.
- The potential market size that the intellectual property makes available.

FN: Investment in a start-up in renewable energy (eg, solar and biomass), with parallel R&D collaboration.

What typically causes your IP-centric deals to go wrong?

AC: In our case, it's overvaluation of the potential market to be covered by the intellectual property, overvaluation of the royalty rate which could be achieved and undervaluation of the time needed to get certain patents issued and/or re-issued.

SD: A bad scenario is for a portfolio company to be sued for patent infringement. Lawyers' fees are not affordable for a small company, and during the course of the lawsuit the company is delayed in its development.

What causes your IP-centric M&A deals to go well?

AC: Our patent team can add significant value to the patent portfolio through prosecution and patent mining, thanks to our technical experts and the patent IT tools that we use.

SD: A good scenario is to become the technology leader in a new market that is poised to grow large. This dramatically increases the value of company.

Variety

If Technicolor, Total and Iris Capital are any indication, there is great variety in the IP management function and the nature of its role. In some companies, it is risk-mitigation focused; in others, it is opportunity focused. In some, its expertise is financial and analytical; in others, its expertise is decidedly legal or technical in orientation. Is there an ideal role for IP management in M&A transactions and licensing transactions? Is there an ideal background for IP management people to support and execute such transactions? These are open questions.

What we do know is that IP management means different things in different companies. What people do when they do IP management is as various as the colours of the sea.

This makes for a rich and interesting conversation when we are honoured by senior IP leaders who are willing to share insight and perspective on how things get done in their companies with one another and with the rest of us. *iam*

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Established in 1965, the Licensing Executives Society (USA and Canada), Inc (LES) is a professional society comprised of over 4,500 members engaged in the transfer, use, development and marketing of technology and intellectual property. The LES membership includes a wide range of professionals, including business executives, lawyers, licensing consultants, engineers, academicians, scientists and government officials. Many large corporations, professional firms and universities comprise its membership. LES is a member society of the Licensing Executives Society International, Inc, with a worldwide membership of more than 10,000 members in 32 national societies, representing over 90 countries. For more information, see *www.lesusacanada.org*

Action plan

Senior IP management leaders should consider several key points when contemplating IP transactions:

- The use of a royalty cap when the technology to be licensed is at an early stage of development and therefore its market value is difficult to gauge or when the investors in the licensee are seeking to attract a buyer.
- The use of an option agreement in collaboration or joint development agreements when the early-stage technology in question is not sufficiently mature to justify substantial payments.
- The assignment of IP management people to lead the sale and acquisition of IP-centric entities – especially companies or product lines in which the predominant or most valuable assets are intangible rather than tangible assets – because IP valuation approaches may be distinctly different from – and better – than enterprise valuation approaches typically taken by M&A professionals.
- In conventional M&A transactions, the development of synergistic approaches that may increase short-term development costs to create new products and new value propositions out of the unique intellectual property of the two parties to be merged – new products that neither party could have offered on its own.